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COMMISSIONER

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Department of Revenue
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February 21, 1985

You inquire as to the Massachusetts income tax withholding requirements of: (1) dependent care assistance paid by the employer to the employee, (2) sick pay, paid to an employee pursuant to a plan to which the employer is a party, (3) distributions from employer deferred compensation plans, individual retirement plans and commercial annuities.

Generally, federal law requires that every employer making payment of wages must deduct and withhold a tax upon such wages. (I.R.C., § 3402(a)(1)).

For federal withholding tax purposes the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer. Certain remuneration is excepted from the definition of wages. (I.R.C., § 3401(a)).

Massachusetts General Laws state that every employer making payments to employees of wages subject to tax shall deduct and withhold a tax upon such wages. (G.L. c.62B, § 2).

In general, Massachusetts withholding provisions follow the federal withholding provisions. Massachusetts specifically adopts the federal definition of wages. Massachusetts law provides that the term "wages" for Massachusetts withholding purposes means wages as defined in Section 3401(a) of the Internal Revenue Code ("Code"), and periodic payments and non-periodic distributions as defined in Section 3405 of the Code and subject to federal withholding. (G.L. c.62B, § 1).

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(1) Massachusetts income tax withholding rules applicable to dependent care assistance.

Subject to certain earned income limitations, dependent care assistance payments provided under an employer's written nondiscriminatory plan (as described in Code Section 129(d)) may be excluded from the employee's federal gross income for federal income tax purposes. (I.R.C., § 129).

For federal withholding tax purposes excluded from the definition of wages is "...any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127 or 129 [of the Code]...." (I.R.C., § 3401(a)(18)).

If at the time of payment of dependent care assistance it is reasonable to believe that the employee will be able to exclude such payment from gross income, such payments are excluded from the federal definition of wages and thus not subject to federal withholding.

Massachusetts adopts the federal definition of wages for withholding purposes and in general follows federal withholding provisions. Therefore, dependent care assistance which is excluded from the definition of wages under Code Section 3401(a) and which is not subject to federal withholding is not subject to Massachusetts withholding.

(2) Massachusetts income tax withholding rules are applicable to sick pay paid to an employee pursuant to a plan to which the employer is a party.

Section 105(a) of the Code provides that:

Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Payments are considered made by the employer if a third party makes the payments as an agent of the employer. (U.S. Treas. Reg. 31.340(a)-1(b)(8)(b)).

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Federal "[w]ithholding is required on all payments of amounts includible in gross income under section 105 (a) ...to an employee under an accident or health plan for a period of absence from work on account of personal injury or sickness. Payments on which withholding is required by this subdivision are wages as defined in section 3401(a)...." (U.S. Treas. Reg. 31.3401(a)-1(b)(8)).

Section 3402(0) provides that "... any payment ... of sick pay which does not constitute wages, if at the time the payment is made a request that such sick pay be subject to withholding under this chapter is in effect, shall be treated as if it were a payment of wages by an employer to an employee for a payroll period."

"The term "wages" includes the gross amount of a sick pay payment with respect to which there is in effect a request for withholding...." (U.S. Treas. Reg. 31.3402(0)-3(f)(3)).

Sick pay included in federal gross income under Code Section 105(a) is subject to federal withholding and constitutes wages as defined in Code Section 3401(a). Therefore, sick pay which is included in the definition of wages under Section 3401(a) and which is subject to federal withholding is subject to Massachusetts income tax withholding.

If the taxpayer elects withholding under Code Section 3402(0) on sick pay not considered wages under Section 3401(a), such pay is treated as if it were a payment of wages and is included in the federal definition of wages. Sick pay which is considered wages for federal purposes and which is subject to federal withholding is subject to Massachusetts income tax withholding.

(3) Massachusetts income tax withholding rules applicable to pensions, annuities and retirement pay.

Section 3405(a)(1) of the Code provides that "[t]he payor of any periodic payment (as defined in subsection (d)(2)) shall withhold from such payment the amount which would be required to be withheld from such payment if such payment were a payment of wages by an employer to an employee for the appropriate payroll period." Section 3405(d)(2) defines periodic payment as a designated distribution which is an annuity or similar periodic payment.

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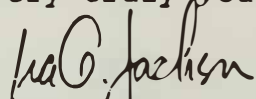
Section 3405(b)(3) of the Code provides that "[t]he payor of any nonperiodic distribution (as defined in subsection (d)(3)) shall withhold from such distribution ...[the designated amount]". Section 3405(d)(3) defines a nonperiodic distribution as any designated distribution which is not a periodic payment.

"A designated distribution is any distribution or payment from or under an employer deferred compensation plan, an individual retirement plan (as defined in section 7701(a)(37)), or a commercial annuity. However, a designated distribution does not include any portion of a distribution which it is reasonable to believe is not includible in the gross income of the payee." (U.S. Treas. Reg. 35.3405-1(A-2)).

An individual may elect to have withholding not apply to periodic distributions (3405(a)(2)) and may elect to have withholding not apply to any non-periodic distributions (3405(a)(3)).

Payments or distributions from an employer deferred compensation plan, an individual retirement plan or commercial annuity subject to federal withholding are subject to Massachusetts withholding. If the recipient has elected against withholding under Code Section 3405(a)(2) or 3405(b)(3) and the payment is not subject to federal withholding, it is not subject to Massachusetts withholding.

Very truly yours,


Commissioner of Revenue

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LR 85-47